



**STATE INVESTMENT BOARD
BOARD ADOPTED POLICIES**

POLICY NUMBER: 2.11.100

EFFECTIVE DATE: 7/1/02

TITLE: Defined Contribution Plan 3
Retirement Funds

SUPERSEDES: 7/19/01

BOARD ADOPTION: 6/20/02

APPROVED:

A handwritten signature in dark ink, appearing to read "B. Bensch", is written over the "APPROVED:" label.

BACKGROUND:

RCW 41.34.120 declares that the assets of the Teachers' Retirement System Plan 3 (TRS 3), School Employees Retirement System Plan 3 (SERS 3), and Public Employees' Retirement System Plan 3 (PERS 3) are held in trust for the exclusive benefit of the participant and that the State Investment Board (SIB) is named as trustee of the assets. Per RCWs 41.34.130 and 43.33A.190, the SIB has the sole authority over selection and management of the investment options. The Employee Retirement Benefits Board (ERBB) may make recommendations to the SIB on types of self-directed options, reflecting of the member's preferences. In accordance with RCW 41.34.130, the SIB, after consultation with the ERBB on such recommendations, will determine the investment options for the programs. The Department of Retirement Systems (DRS) has responsibility for program administration, investment accounting, and participant record keeping, education, and communication.

TRS 3, SERS 3, and PERS 3 are hybrid pension plans comprised of a defined benefit and a defined contribution plan. The employer contribution funds a one percent formula defined benefit. The employee contribution is invested in a defined contribution 401(a) program. The employee sets the contribution rate from a menu of options and directs the investment of the funds. Within the investment options, the employee may invest his/her contributions into the Commingled Trust Fund (CTF) through the Total Allocation Portfolio (TAP). The employee contribution is a self-directed retirement account; therefore, the employee's proper selection of options, or asset allocation, is critical for sufficient growth of the funds and for meeting the employee's desired retirement goals.

Since TRS 3, SERS 3, and PERS 3 are similar in structure and identical in purpose and intent, the standard of care, investment objective, risk constraints, investment structure, and investment options for each are identical. Therefore, all plans are combined into this single investment policy (Plan 3 Retirement Funds).

PURPOSE:

This document outlines the investment policy for the assets of the programs. It is designed to articulate the SIB's investment objectives and risk tolerance for the investment options in accordance with RCW 43.33A.110, 43.33A.140, 43.33A.190, 41.34.060 and 41.34.130. This document also formulates the Board's policies and guidelines on: 1) the number and type of options; 2) the investment style and strategy for each specific investment option; and, 3) prudently monitoring and evaluating the performance and risk of the investment options.

STANDARD OF CARE:

Under RCW 41.34.120 and 43.33A.030, trusteeship of all defined contribution funds is vested in the voting members of the Board. The Legislature has established a standard of care for investment of these funds in RCW 43.33A.140. Additionally, the Board and its staff must comply with other state laws, such as the Ethics In Public Service Act, Chapter 42.52 RCW, as it makes its investment decisions and seeks to meet the investment objectives listed below.

INVESTMENT OBJECTIVES:

In accordance with RCW 43.33A.110, the investment options of all assets under the control of the SIB, which includes the assets in the programs, are seeking the maximum return at a prudent level of risk. The SIB has a fiduciary duty to ensure that each Plan's self-directed program offers a balance of options that will allow employees an asset allocation suitable for a range of participants, from new employees to those in retirement. The investment options must cover a broad spectrum of funds from low risk/low return to high risk/high return. The majority of the options must offer participants the opportunity to seek long-term capital appreciation.

Based on this requirement the order of the objectives shall be:

1. Provide a diverse set of investment options to allow participants to invest their funds to maximize their future capital accumulation for retirement at their personal level of risk tolerance.
 2. Provide an adequate number of options. The number of options should be broad enough to offer a comprehensive set of options, yet be limited in number to make the programs simple to understand and offer the participant the ease of creating a diverse portfolio.
 3. Minimize expenses to the participants.
 4. Ensure that each investment option maintains its investment objectives and investment strategy as described to participants.
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5. Provide investment options that will not compromise the participant's confidence in the programs.

In keeping with these objectives, to be an efficient and cost-effective investment menu, it must be understood that not every participant's unique desire or request can be met. Participants' requests for specialized funds or highly focused investment strategies are best obtained through their own personal investments. This list of options is designed to provide the best menu of investment options for a broad group of participants and cannot be all things to each individual person.

RISK CONSTRAINT STANDARDS:

1. All assets under management by the SIB are to be invested to maximize return at a prudent level of risk in accordance with the requirements of RCW 43.33A.110 and RCW 43.33A.140. Within each Plan, the SIB will offer investment options that are suitable for long-term retirement investments for individuals.
2. Ensure that the stable value/money market option is invested in a manner to facilitate the maintenance of a one-dollar net asset value.
3. Ensure that each investment option is within its prescribed level of risk.

INVESTMENT PERFORMANCE OBJECTIVES:

Since each participant in the employee portion of the Plan is responsible for the design and selection of their investment portfolio, the overall program does not have an aggregate investment performance objective. However, each investment option described below will have a specific investment performance objective.

ASSET ALLOCATION AND INVESTMENT OPTIONS:

The SIB will offer the investment options listed below for each Plan. The SIB will adjust the investment management of the options, as the SIB deems necessary.

Capital market conditions, management style of investment options, and investment performance are dynamic, not static. Consequently, the SIB staff will review the performance and management of the options with the ERBB and DRS administrative staff quarterly. For those options managed internally by the SIB, the Board has delegated to the executive director the authority to invest the funds according to the procedures established in the SIB Investment Policies & Procedures, Volume 3.

Within the limit on the number of options, the SIB will strive to offer a comprehensive array of options to include balanced life cycle funds and active and passive management styles.

INVESTMENT OPTIONS:

ASSET CLASS	STYLE	FUND
Balanced	Balanced equity/debt fund	Total Allocation Portfolio Washington State Horizon Funds: - Long Horizon - Mid Horizon - Short Horizon
U.S. Equities	Passive broad market index	U.S. Stock Fund U.S. Large Stock Fund U.S. Small Stock Fund
Non-U.S. Equities	Passive non-U.S. equity	International Stock Fund
Fixed Income	Active intermediate bond fund	Bond Market Fund
Stable Value	Short-term investment Fund	Money Market Fund

INVESTMENT OPTIONS, OBJECTIVE, AND STYLE:

Total Allocation Portfolio (TAP)

Objective: A balanced Fund that seeks to achieve a maximum long-term rate of return at a prudent level of risk. The Fund's long-term objective is to exceed the median return of other public pension plans that represent the Fund's peer group.

Strategy: The TAP Fund is invested into the SIB CTF which is comprised of the other defined benefit retirement plans. It has an aggressive asset allocation, which includes U.S. equity, non-U.S. equity, actively managed fixed income, U.S. and non-U.S. private equity and real estate, and short-term instruments. The portfolio includes private securities that are not actively priced on a regular basis; therefore, the credited return is an approximation of the overall portfolio. The Fund value is determined monthly.

Benchmark: Custom blend matched to the Retirement CTF Asset Allocation Policy 2.10.050.

Washington State Horizon Funds

Long Horizon

Objective: A balanced Fund managed for participants with a long investment horizon. The Fund seeks to achieve a maximum long-term rate of return and accepts large fluctuations in the year-to-year returns. The Fund has a target asset allocation that places the majority of the fund in U.S. and non-U.S. equities.

Strategy: The Fund will invest passively in the broad indices that track the U.S. and the non-U.S. equity markets, and an actively managed intermediate duration bond fund. The asset allocation is actively rebalanced to maintain the target mix.

Benchmark: Custom blend matched to the target allocation using the component benchmarks of the Horizon Funds Policy 2.14.100.

Mid Horizon

Objective: A balanced Fund managed for participants with a medium-term investment horizon. The Fund seeks to achieve a maximum rate of return and accepts fluctuations in the year-to-year returns. The Fund has a target asset allocation that places slightly more than half of the Fund in U.S. and non-U.S. equities, and just less than half in U.S. Fixed Income.

Strategy: The Fund will invest passively in the broad indices that track the U.S. and the non-U.S. equity markets, and an actively managed intermediate duration bond fund. The asset allocation is actively rebalanced to maintain the target mix.

Benchmark: Custom blend matched to the target allocation using the component benchmarks of the Horizon Funds Policy 2.14.100.

Short Horizon

Objective: A balanced Fund managed for participants with a short-term investment horizon. The Fund seeks a more conservative rate of return, but with some fluctuations in the volatility of the year-to-year returns. The Fund has a target asset allocation that places a majority of the Fund in lower risk and return bonds and cash investments while still investing some in U.S. and non-U.S.

Strategy: The Fund will invest passively in the broad indices that track the U.S. and the non-U.S. equity markets, an actively managed intermediate duration bond fund, and short-term cash investments. The asset allocation is actively rebalanced to maintain the target mix.

Benchmark: Custom blend matched to the target allocation using the component benchmarks of the Horizon Funds Policy 2.14.100.

U.S. Stock Fund

Objective: Passively managed to approximate the return of the Russell 3000 index within a tracking error of 30 basis points annually.

Strategy: To invest in U.S. and some non-U.S. equities, futures and options in order to approximate the characteristics and performance of the broad U.S. stock market.

Benchmark: Russell 3000

U.S. Large Stock Fund

Objective: Passively managed to approximate the return of the Standard & Poor's 500 (S&P 500) index within a tracking error of 5 basis points annually.

Strategy: To invest in U.S. and some non-U.S. equities, futures and options in order to approximate the characteristics and performance of the S&P 500 index.

Benchmark: S&P 500

U.S. Small Stock Fund

Objective: Passively managed to approximate the return of the Russell 2000 index within a tracking error of 20 basis points annually.

Strategy: To invest in U.S. and some non-U.S. equities, futures and options in order to approximate the characteristics and performance of the smaller capitalized stocks in the U.S. that comprise the Russell 2000 index.

Benchmark: Russell 2000

International Stock Fund

Objective: Passively managed to approximate the return of the non-U.S. equities markets as tracked by the Morgan Stanley Capital Markets Europe, Australia, Far East Index, (MSCI EAFE) within a tracking error of 20 basis points annually.

Strategy: To invest in non-U.S. and some U.S. equities, futures and options in order to approximate the characteristics and performance of the MSCI EAFE index.

Benchmark: MSCI EAFE

Bond Market Fund

Objective: The Fund seeks a high level of current income. The Fund is expected to meet or exceed the return of the Lehman Intermediate Credit index.

Strategy: The Fund will invest in investment grade rated U.S. and dollar denominated non-U.S. fixed income instruments. The average portfolio maturity will range between three to ten years.

Benchmark: Lehman Intermediate Credit Index

Money Market Fund

Objective: The money market option seeks to protect principal while generating an income return in excess of inflation. The Fund is expected to maintain a one-dollar net asset value.

Strategy: The Fund will invest in high quality short term securities.

Benchmark: One-month LIBOR

PERFORMANCE REVIEW GUIDELINES AND REPORTING:

Since the SIB does not perform investment fund accounting for these programs, the specific investment manager will measure investment performance of the external options. Performance of the TAP Fund, the Horizon Fund, and the Bond Market Fund will be reported by the SIB staff. The SIB investment staff will compile and perform a quality check of the returns from the investment managers and report quarterly to the Board and ERBB for each Plan. The quarterly report will identify the distribution of the participant's assets among the various options for each plan and compare each option to its appropriate benchmark.

POLICY (IMPLEMENTATION):

The Board has established numerous policies and procedures for the investment staff to ensure consistent and efficient handling of the investment duties. The Board regularly reviews performance and costs of all funds under its control. On a semi-annual basis, the Board reviews all the investment costs of the SIB, including investment management and external service providers. Any direct costs related to the management of Fund assets will be deducted from the return of the various investment options. Additionally, under RCW 43.33A.160, the SIB is allowed to deduct from the funds under its control the Fund's proportional share of the SIB's operating expenses, based on its assets, under management.

RESPONSIBILITIES:

State Investment Board - Responsible for approving the investment policy, setting the investment options, and reviewing the investment performance of the options.

Public Markets Committee - Responsible for reviewing and recommending the investment policy and investment options to the Board. Also, responsible for reviewing the SIB staff's investment management guidelines.

SIB Staff - Responsible for direct management and daily pricing/unitization of the internally managed investment options; oversight, monitoring and evaluating the external investment managers; and preparing and presenting the quarterly investment report. Additionally, responsible for recommending enhancements and changes to the investment policy and investment options to the Public Markets Committee; and, implementing the policy changes, managing the assets, and reporting performance and compliance to the policy (custody account management) to the Public Markets Committee, the ERBB, and the Board.

Employee Retirement Benefits Board - Responsible for consulting with the SIB regarding recommendations for options for participants to choose for investment of the deferred portion of their income (RCW 41.34.130).

Original Policy Adopted 7/20/00

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